

## Escorts (ESCORT)

₹ 79

### WHAT'S CHANGED...

PRICE TARGET .....	Changed from ₹ 76 to ₹ 73
EPS (SY12E).....	Changed from ₹ 8.4 to ₹ 6.6
EPS (SY13E).....	Changed from ₹ 12.6 to ₹ 11.7
RATING.....	Changed from Buy to Hold

### Another round of disappointment...

Escorts witnessed another muted performance with Q1SY12 results coming below our expectations as the railway and ancillary division reported losses. The topline came in at ₹ 829.8 crore (I-direct estimate: ₹ 894.9 crore) reflecting a decline of ~1% YoY. Tractor sales volumes for the quarter stood at 16,606 units (up 9.2% YoY) but ASPs were up ~2.2% sequentially. EBITDA margins contracted sharply to 4.0% (down 106 bps QoQ) on account of the inability to pass costs coupled with lower operating leverage. The RM cost/unit rose 2.1% QoQ and employee expenses jumped ~20.2% QoQ pushing margins lower. Higher interest cost was due to ₹ 50 crore loan taken for ECL. On the tax front, there was a write off of provision for doubtful debts leading to a PAT of ₹ 10.9 crore (down 57.3% YoY), which was well below our estimates (₹ 24.4 crore).

#### Highlights of the quarter

Escorts' tractor sales witnessed lacklustre sales growth (up ~1.7% YoY) to 16,606 units, which is below par compared to its peers (M&M tractor volumes up ~12.2% YoY). This is reflective of Escort's lack of presence in the fast growing southern and western regions. Escorts derives ~45% of its sales from the saturated northern region. We expect it to grow ~7-9%, going ahead. The management is confident of ~20% growth in the southern and eastern geographies. However, we do not share the same enthusiasm and have not factored in the same in our estimates. The high margin (~20%) railway equipment division's (RED) EBIT slipped into loss of ₹ 0.6 crore against a profit of ₹ 10.9 crore in Q4SY11 owing to high fixed cost, lower turnover and lack of order mobilisation. Also, the auto ancillary division reported a net loss of ₹ 4.97 crore.

### Valuation

We remain cautious on Escorts owing to sluggish demand scenario thereby leading to lack of pricing power and have accordingly pruned our estimates. The stock is currently trading at ₹ 79, 6.8x SY13E EPS of ₹ 11.7. We have valued it on an SOTP basis with Escorts valued at 6x SY13E EPS of ₹ 11.7 and the subsidiary valued at ₹ 3.2 to arrive at a target price of ₹ 73. We have changed our rating on the stock to **HOLD**.

#### Exhibit 1: Valuation metrics

(₹ Crore)	Q1SY12	Q1SY12E	Q1SY11	Q4SY11	QoQ (Chg %)	YoY (Chg %)
Total Operating Income	829.8	894.9	837.7	773.0	7.3	-1.0
EBITDA	33.4	49.0	43.8	39.3	-15.1	-23.8
EBITDA Margin (%)	4.0	5.5	5.2	5.1	-106 bps	-121 bps
Depreciation	9.7	12.2	10.0	9.7	0.2	-2.3
Interest	11.4	6.1	3.7	8.0	42.6	209.3
Reported PAT	10.9	24.0	25.5	8.8	23.9	-57.3
EPS (₹)	1.1	2.3	2.5	0.9	23.9	-57.3

Source: Company, ICICIdirect.com Research

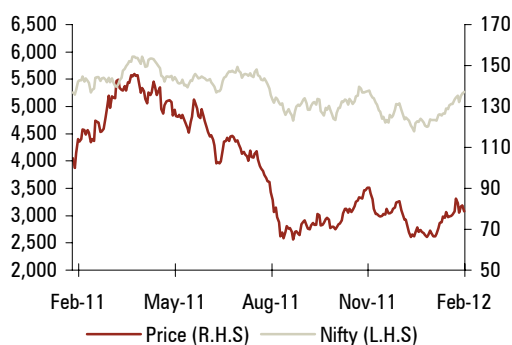
Rating matrix	
Rating	: <b>Hold</b>
Target	: ₹ 73
Target Period	: 12 months
Potential Upside	: -7%

Key Financials (Standalone)				
₹ Crore	SY10	SY11E	SY12E	SY13E
Net Sales	2,746	3,252.1	3,518.3	3,918.9
EBITDA	231.2	175.1	165.7	234.3
Net Profit	137.6	120.7	67.2	119.2
EPS (₹)	13.4	11.8	6.6	11.7

Valuation summary (Standalone)				
	SY10	SY11E	SY12E	SY13E
P/E	5.9	6.7	12.0	6.8
Target P/E	5.4	6.2	11.1	6.3
EV / EBITDA	2.4	3.0	3.1	2.3
P/BV	0.5	0.4	0.4	0.4
RoNW	7.9	6.7	3.6	6.1
RoCE	8.9	6.3	5.7	8.4

Stock data	
Market Capitalization	805.4
Total Debt (SY11E)	372.6
Cash and Investments (SY11E)	652.4
EV	525.7
52 week H/L	149/63
Equity capital	102.3
Face value	₹ 10
MF Holding (%)	17.5%
FII Holding (%)	20.6%

#### Price movement



#### Analyst's name

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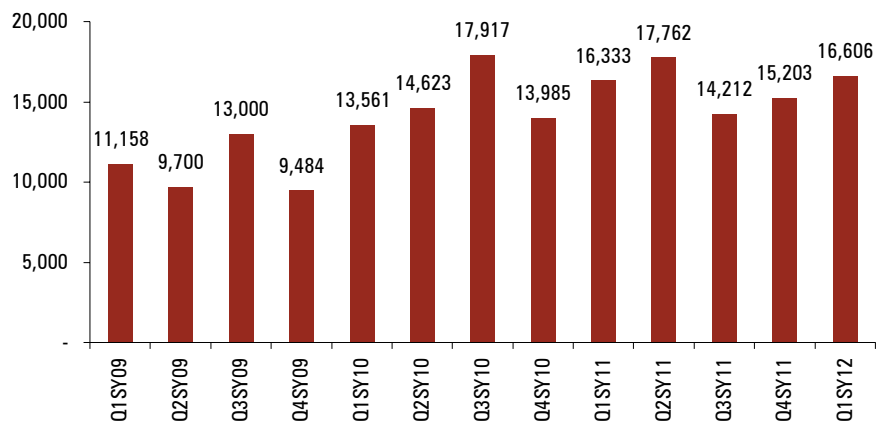
**Result analysis**

Escorts is facing the twin challenge of demand slowdown coupled with inability to pass on the rise in commodity prices. The company has taken a price hike of ~1.5% in January to partially offset commodity pressures. Moreover, the northern region, which accounts for ~45% of the company's volumes, is witnessing slower offtake in the replacement market. However the marketing efforts stepped up in the southern markets during Q3-Q4SY11 has led to some incremental market share gains (90 bps QoQ) at 11.7%. On the segmental front, the RED division, which is historically a high margin business (~20%), has slipped into EBIT losses due to lack of orders inflows from Indian railways. Also, postponement of the same has resulted in lower turnover (down ~45% QoQ). Apart from this, strong competition in the agri-machinery division rules out the possibility of margin expansion and market share gains in the near term.

We continue to remain positive on the Escorts Construction Equipment Ltd (ECL) business as infrastructure demand starts to pickup in FY13-14E. We expect the business to witness ~30% YoY growth with higher sales of back-hoe loaders and pick-n-carry cranes. Escorts has taken an additional loan to the tune of ₹ 50 crore for ECL pressurizing interest burden.

Tractor volumes increased marginally by ~1.7% YoY, which is sluggish in comparison to its peers (M&M tractor volumes up ~12.2% YoY). Both M&M and John Deere continue to gain market share in both the slow growing northern region and rapidly growing western and eastern regions

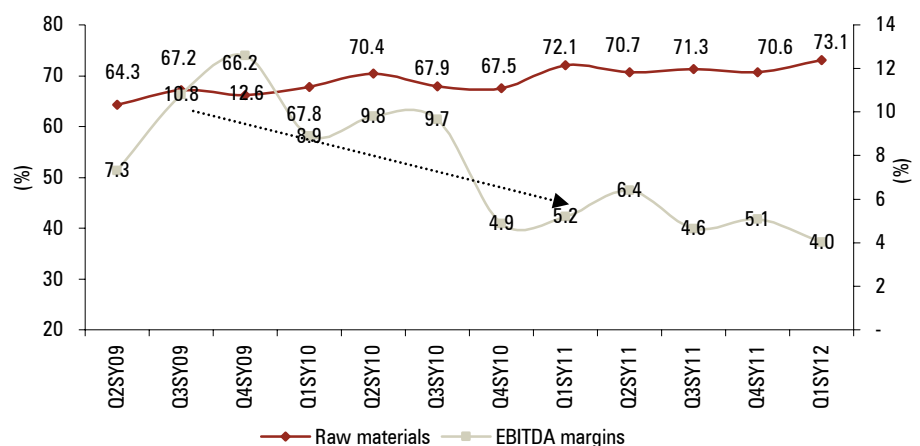
**Exhibit 2: Tractor sales volume trend**



Source: ICICIdirect.com Research

Escorts witnessed margin contraction to the tune of 106 bps QoQ as cost per vehicle moved up ~2.1% QoQ. The raw material costs as proportion of sales increased ~250 bps QoQ on account of sluggish volume offtake leading to lower operating leverage

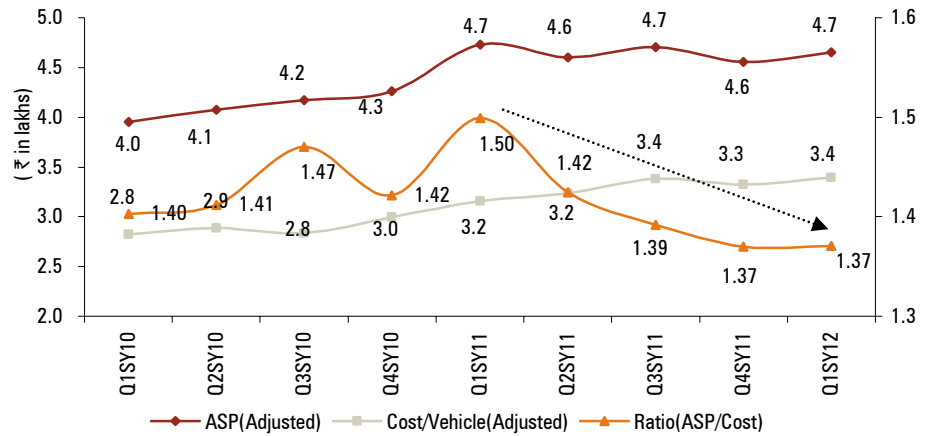
**Exhibit 3: Margins, raw material cost trends as percentage to total income**



Source: Company, ICICIdirect.com Research

The EBITDA margin decline can be attributed to a rise in costs in the core business, which could not get offset due to lack of pricing power and lacklustre sales performance of other business segments

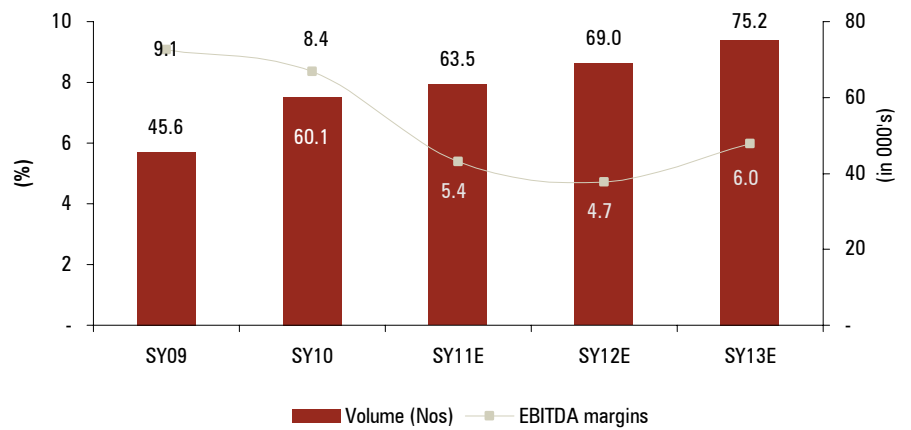
**Exhibit 4: Costs and ASP analysis**



Source: Company, ICICIdirect.com Research \* ASP ~ Average selling prices

Escorts' tractor margins are bleak compared to peers like M&M. Lack of pricing power reflecting in inability to pass costs coupled with weak demand will drag margins. However, we expect the scenario to improve in SY13E and expect volumes to grow at a CAGR of 8.7% over SY11-13E with margins expected to touch 6% levels by SY13E

**Exhibit 5: Volume and margin trends**



Source: Company, ICICIdirect.com Research

## Valuation

We remain cautious on Escorts owing to sluggish demand scenario thereby leading to lack of pricing power and have accordingly pruned our estimates. However, a sharp decline in commodity prices will provide an upside risk to our estimates. The stock is currently trading at ₹ 79, 6.8x SY13E EPS of ₹ 11.7. We have valued it on an SOTP basis with Escorts valued at 6x SY13E EPS of ₹ 11.7 and the subsidiary valued at ₹ 3.2 to arrive at a target price of ₹ 73. We have changed our rating on the stock to **HOLD**.

### Exhibit 6: Revised financials (Standalone)

Particulars (₹ crore)	SY12E			SY13E		
	Old	New	% Change	Old	New	% Change
Net Sales	3606.3	3518.3	(2.4)	3,927.3	3918.9	(0.2)
EBITDA	181.1	165.7	(8.5)	243.2	234.3	(3.6)
EBITDA Margin %	5.0	4.7	-31 bps	6.2	6.0	-21 bps
Net Profit	85.6	67.2	(21.5)	128.8	119.2	(7.5)
EPS(₹)	8.4	6.6	(21.5)	12.6	11.7	(7.5)

Source: Company, ICICIdirect.com Research

### Exhibit 7: Financial metrics

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
SY10	2745.7		13.4		5.9	2.4	7.9	8.9
SY11E	3252.1	18.4	11.8	-12.2	6.7	3.0	6.7	6.3
SY12E	3518.3	8.2	6.6	-44.4	12.0	3.1	3.6	5.7
SY13E	3918.9	11.4	11.7	77.5	6.8	2.3	6.1	8.4

Source: Company, ICICIdirect.com Research

## Financial summary

### Profit and loss statement

	(₹ Crore)			
(Year-end March)	SY10	SY11E	SY12E	SY13E
Total operating Income	2,764.7	3,252.1	3,518.3	3,918.9
Growth (%)	26.8	17.6	8.2	11.4
Raw Material Expenses	1,862.7	2,315.4	2,541.3	2,759.6
Employee Expenses	289.2	327.9	368.2	402.2
Other expenses	381.5	433.6	443.1	522.9
Total Operating Expenditure	2,533.5	3,077.0	3,352.6	3,684.6
EBITDA	231.2	175.1	165.7	234.3
Growth (%)	108.2	-24.3	-5.4	41.4
Depreciation	49.0	38.9	39.5	41.1
Interest	11.7	25.5	43.1	34.3
Other Income	0.1	0.0	0.0	0.0
PBT	188.0	101.3	81.2	158.9
Total Tax	50.5	-19.5	14.1	39.7
PAT	137.6	120.7	67.2	119.2
Growth (%)	53.3	-12.2	-44.4	77.5
EPS (₹)	13.4	11.8	6.6	11.7

Source: Company, ICICIdirect.com Research

### Balance sheet

	(₹ Crore)			
(Year-end March)	SY10	SY11E	SY12E	SY13E
<b>Liabilities</b>				
Equity Capital	102.3	102.3	102.3	102.3
Reserve and Surplus	1,635.4	1,696.2	1,745.5	1,846.8
ESOP	0.5	0.5	0.5	0.5
Total Shareholders funds	1,738.1	1,798.9	1,848.2	1,949.5
Total Debt	298.6	372.6	357.6	342.6
Total Liabilities	2,036.7	2,171.5	2,205.8	2,292.1
<b>Assets</b>				
Gross Block	2,048.2	2,145.8	2,235.8	2,325.8
Less: Acc Depreciation	603.4	641.1	678.7	717.9
Net Block	1,444.8	1,504.7	1,557.1	1,607.8
Capital WIP	10.7	10.7	10.7	10.7
Total Fixed Assets	1,455.5	1,515.4	1,567.8	1,618.6
Net Intangible Asset	4.9	3.0	1.2	47.3
Investments	365.8	365.8	365.8	380.8
Inventory	295.5	327.3	346.5	404.0
Debtors	332.6	340.4	368.2	410.1
Loans and Advances	258.9	270.5	302.2	335.7
Other Current Assets	0.8	7.1	1.5	8.0
Cash	183.4	286.6	275.9	229.2
Total Current Assets	1,071.2	1,231.8	1,294.3	1,387.1
Creditors	731.0	881.6	953.8	1,062.4
Provisions	136.7	79.3	85.8	95.6
Total Current Liabilities	867.8	961.0	1,039.6	1,158.0
Net Current Assets	203.5	270.8	254.7	229.1
Deferred Tax Asset	5.1	16.4	16.4	16.4
Misc. exp not written off	2.0	0.1	0.1	0.1
Application of Funds	2,036.7	2,171.5	2,205.8	2,292.1

Source: Company, ICICIdirect.com Research

### Cash flow statement

	(₹ Crore)			
(Year-end March)	SY10	SY11E	SY12E	SY13E
Profit after Tax	137.6	120.7	67.2	119.2
Add: Depreciation	49.0	38.9	39.5	41.1
(Inc)/dec in Current Assets	-221.9	-57.4	-73.1	-139.6
Inc/(dec) in CL and Provisions	9.8	93.2	78.7	118.4
CF from operating activities	-25.5	195.4	112.3	139.1
(Inc)/dec in Investments	-130.0	0.0	0.0	-15.0
(Inc)/dec in Fixed Assets	-41.8	-96.9	-90.0	-138.0
Others	3.5	1.9	0.0	0.0
(Inc)/dec in Deferred Tax Asset	22.8	-11.3	0.0	0.0
CF from investing activities	-145.6	-106.3	-90.0	-153.0
Issue/(Buy back) of Equity	11.6	0.0	0.0	0.0
Inc/(dec) in loan funds	33.3	74.0	-15.0	-15.0
Dividend paid & dividend tax	-18.9	-17.9	-17.9	-17.9
Inc/(dec) in Sec. premium	174.6	0.0	0.0	0.0
Others	-10.9	-42.1	0.0	0.0
CF from financing activities	189.7	14.1	-32.9	-32.9
Net Cash flow	18.6	103.1	-10.6	-46.8
Opening Cash	164.8	183.4	286.6	275.9
Closing Cash	183.4	286.6	275.9	229.2

Source: Company, ICICIdirect.com Research

### Key ratios

(Year-end March)	SY10	SY11E	SY12E	SY13E
<b>Per share data (₹)</b>				
EPS	13.4	11.8	6.6	11.7
Cash EPS	18.2	15.6	10.4	15.7
BV	169.9	175.9	180.7	190.6
DPS	1.6	1.5	1.5	1.5
Cash Per Share	17.9	28.0	27.0	22.4
<b>Operating Ratios</b>				
EBITDA Margin (%)	8.4	5.4	4.7	6.0
PBT / Net sales (%)	6.8	3.1	2.3	4.1
PAT Margin (%)	5.0	3.7	1.9	3.0
Inventory days	32.9	35.0	35.0	35.0
Debtor days	44.2	38.2	38.2	38.2
Creditor days	97.2	99.0	99.0	99.0
<b>Return Ratios (%)</b>				
RoE	7.9	6.7	3.6	6.1
RoCE	8.9	6.3	5.7	8.4
RoC	7.2	8.7	5.5	7.1
<b>Valuation Ratios (x)</b>				
P/E	5.9	6.7	12.0	6.8
EV / EBITDA	2.4	3.0	3.1	2.3
EV / Net Sales	0.2	0.2	0.1	0.1
Market Cap / Sales	0.3	0.2	0.2	0.2
Price to Book Value	0.5	0.4	0.4	0.4
<b>Solvency Ratios</b>				
Debt/EBITDA	1.3	2.1	2.2	1.5
Debt / Equity	0.2	0.2	0.2	0.2
Current Ratio	1.2	1.3	1.2	1.2
Quick Ratio	1.0	1.0	1.0	1.0

Source: Company, ICICIdirect.com Research

### ICICIdirect.com Research coverage universe (Auto)

Tata Motors				Sales (₹ cr)	EPS (₹)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)	
Idirect Code	TELCO	CMP(₹)	246	FY10	92519.3	9.0	27.3	9.2	31.3	18.3
		Target(₹)	241	FY11	123133.3	29.1	8.5	4.9	46.0	24.2
Mcap (₹cr)	72200	% Upside	-2.1	FY12E	156457.9	30.6	8.1	4.1	35.2	24.0
				FY13E	173795.2	34.0	7.3	3.4	29.6	24.2
Maruti Suzuki										
Idirect Code	MARUTI	CMP(₹)	1218	FY10	28,958.5	88.2	13.8	6.9	21.5	24.5
		Target(₹)	1275	FY11	36,128.2	79.2	15.4	7.5	16.5	17.5
Mcap (₹cr)	35190	% Upside	4.7	FY12E	32,215.9	46.8	26.0	11.9	9.0	8.0
				FY13E	39,504.6	85.0	14.3	7.1	14.3	15.0
M&M										
Idirect Code	MAHMAH	CMP(₹)	701	FY10	18602.1	35.9	13.3	13.9	31.9	25.8
		Target(₹)	714	FY11	23493.7	40.6	11.7	12.2	29.3	26.0
Mcap (₹cr)	42947	% Upside	2.0	FY12E	30088.8	43.4	11.0	11.1	24.3	24.3
				FY13E	34000.8	48.5	9.8	9.4	23.6	25.1
Bajaj Auto										
Idirect Code	BAAUTO	CMP(₹)	1,607	FY10	12,043.5	58.8	27.3	17.0	58.1	55.0
		Target(₹)	1,460	FY11	16,975.0	115.4	13.9	12.4	68.0	59.1
Mcap (₹cr)	46515	% Upside	-9.2	FY12E	20,238.4	103.6	15.5	9.4	47.1	58.0
				FY13E	22,208.1	112.3	14.3	8.6	42.9	52.1
Escorts										
Idirect Code	ESCORT	CMP(₹)	79	SY10	2,764.7	13.4	5.9	2.3	7.9	8.9
		Target(₹)	76	SY11	3,252.1	11.8	6.7	2.9	6.7	6.3
Mcap (₹cr)	805	% Upside	-3.2	SY12E	3,606.3	8.4	9.4	2.7	4.6	6.0
				SY13E	3,927.3	12.6	6.3	1.8	6.5	8.3
Hero MotoCorp										
Idirect Code	HERHON	CMP(₹)	1971	FY10	19,669.3	111.8	17.6	12.4	64.4	70.0
		Target(₹)	1824	FY11	19,401.2	96.5	20.4	12.9	65.2	74.1
Mcap (₹cr)	39417	% Upside	-7.5	FY12E	23,604.2	120.2	16.4	9.0	86.1	90.1
				FY13E	25,775.6	130.3	15.1	8.2	92.4	97.0

Source: Company, ICICIdirect.com Research

### Exhibit 8: Recommendation History



Source: ICICIdirect.com Research

### Exhibit 9: Recent Releases

Date	Event	CMP	Target Price	Rating
8-Apr-11	Q2SY11 Preview	145	154	HOLD
5-May-11	Q2SY11 Result Update	127	136	HOLD
5-Jul-11	Q3SY11 Preview	116	128	BUY
9-Aug-11	Q3SY11 Result Update	84	91	HOLD
5-Oct-11	Q4SY11 Preview	71	91	BUY
14-Oct-11	Event Update	80	91	BUY
30-Nov-11	Q4SY11 Result Update	79	86	HOLD
6-Jan-12	Q1SY12 Preview	67	76	BUY

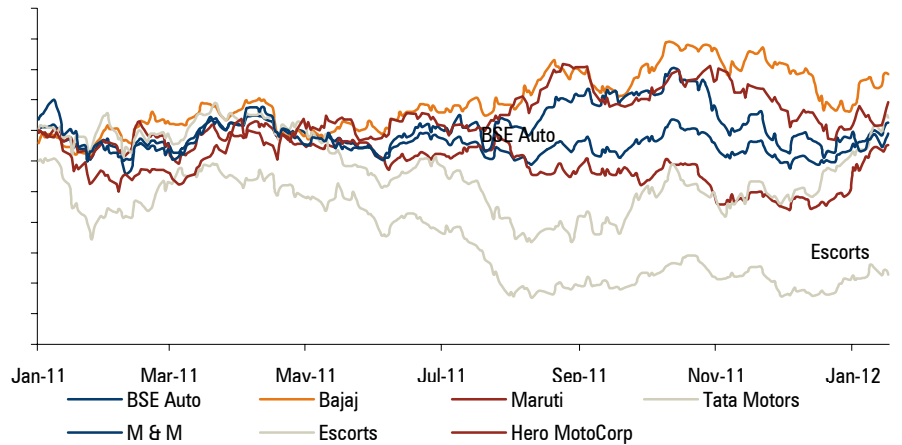
Source: Company, ICICIdirect.com Research

**ICICIdirect.com Universe price movement vis-à-vis BSE Auto index**

The chart compares the movement of OEM stocks in the ICICIdirect.com Universe with the BSE Auto index, thereby reflecting the degree of mimicking of the index

Since January 2011, Bajaj Auto and M&M have outperformed while Maruti Suzuki and Escorts have underperformed in comparison to the index by being divergent on the upside and downside, respectively

**Exhibit 10: OEM comparison with BSE Auto**

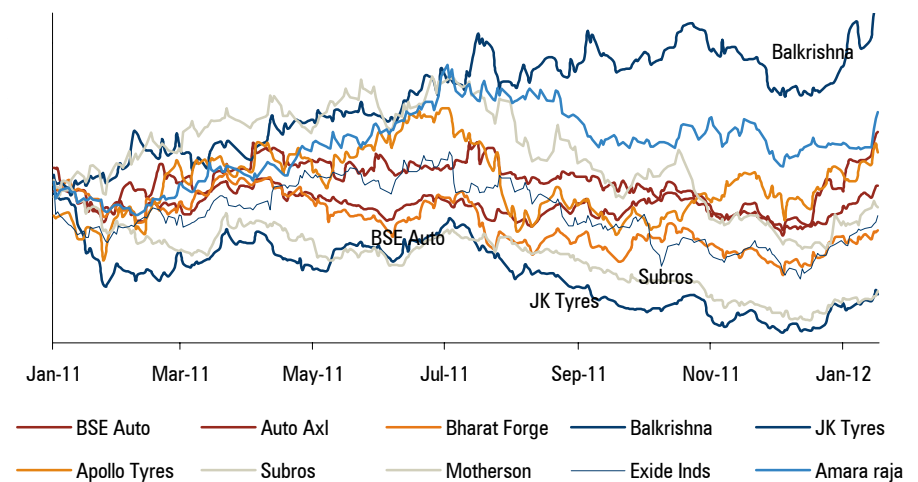


Source: Company, ICICIdirect.com Research

The chart compares the movement of auto ancillary stocks in the ICICIdirect.com universe with the BSE Auto index

The volatile nature of smaller ancillary companies is reflected. These have met with numerous fluctuations with the exception of larger market capitalisation companies like Exide Industries, which mimic the index greatly. JK Tyre and Subros have grossly underperformed due to the intense rubber price overhang and production disruption at Maruti, respectively

**Exhibit 11: Ancillaries comparison with BSE Auto**



Source: Company, ICICIdirect.com Research

## **RATING RATIONALE**

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Hold and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

**Strong Buy:** > 15%/20% for large caps/midcaps, respectively, with high conviction;

**Buy:** > 10%/15% for large caps/midcaps, respectively;

**Hold:** Up to +/-10%;

**Sell:** -10% or more;

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